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International Economic & Energy Weekly

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17 February 1984

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International Economic & Energy Weekly [redacted]

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Synopsis

1 **Perspective—*Supply Response to an Oil Disruption*** [redacted] 25X1

Recent shelling of border towns by Iraq and Iran and an Iraqi attack on a petrochemical plant at Bandar-e Khomeyni may presage a major escalation in the fighting that could threaten oil exports from the Persian Gulf. The 3 million b/d of surplus capacity presently outside the Gulf could offset less than half of the oil that would be lost by a complete closure of the Strait of Hormuz. [redacted] 25X1

13 **International Oil Market: Role of Surplus Capacity** [redacted] 25X1

While the current supply cushion is ample to keep the oil market soft under present circumstances, it is not adequate to overcome a major supply disruption in the Persian Gulf. [redacted] 25X1

19 **South Korea: Strong Economy Boosting Chun's Prospects** [redacted] 25X1

South Korean President Chun's political standing has been given a big boost by the economy's strong performance in 1983. We believe the odds favor continued high growth and low inflation in 1984 and beyond, which will help undercut criticism by Chun's opponents and broaden public support for his government. [redacted] 25X1

23 **Nicaragua: The Search for Oil Suppliers** [redacted] 25X1

Nicaragua's short-term economic prospects hinge on enlisting foreign patrons to foot a substantial share of its $135 million annual oil bill. Most likely candidates are the USSR and such sympathetic Middle East countries as Algeria and Libya. [redacted] 25X1

27 **International Financial Situation: Current Account Outlook for Major Troubled Debtors** [redacted] 25X1

This article is part of our series on economic and political aspects of the international financial situation. We estimate that the 10 largest troubled debtors outside the Soviet Bloc will record a combined current account deficit of about $10 billion this year—a $3 billion improvement over last year and $30 billion better than the deficits registered in 1981 and 1982. [redacted] 25X1

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Perspective

Supply Response to an Oil Disruption [redacted] 25X1

Recent shelling of border towns by Iraq and Iran and an Iraqi attack on a petrochemical plant at Bandar-e Khomeyni may presage a major escalation in the fighting that could threaten oil exports from the Persian Gulf. Baghdad has been threatening such an escalation because of its economic difficulties, Iran's rejection of mediation efforts, and Tehran's apparent intention of pursuing a war of attrition. To reverse its financial disadvantage and raise the stakes for the major powers to intervene in the stalemated conflict, Iraq has threatened strikes against Iranian oil exports. Iran in turn has warned that, if its oil exports are significantly reduced by Iraqi attacks, it would close the Gulf and attack oil installations throughout the area. [redacted] 25X1

Physical damage to oil export facilities and attacks against oil tankers pose the greatest threats to Gulf supplies. [redacted] Lloyds of 25X1 London is currently considering raising insurance rates for tankers calling at Khark Island—Iran's main oil export terminal. Increased security precautions at oil installations in Saudi Arabia, Kuwait, and the United Arab Emirates (UAE) also reflect heightened concern over more widespread fighting. The Saudis have increased their oil in storage outside the Gulf to 45-50 million bar- 25X1 rels. [redacted] 25X1 Unilaterally, the UAE has offered the United States the use of its ports during an emergency. 25X1 Iran has the capability to blockade or mine the Strait of Hormuz as long as its actions are not contested by Western navies. [redacted] 25X1

Should a disruption occur, the willingness of nonaffected producers to increase production and the availability of oil stocks will be the major factors in determining how much of the shortfall can be offset. While we estimate that surplus oil productive capacity worldwide is presently about 8 million b/d, most of this—about 5 million b/d—is in the Persian Gulf. The nearly 3 million b/d of surplus capacity presently outside the Gulf could offset less than half of the oil that would be lost by a complete closure of the Strait of Hormuz. [redacted] 25X1

Another problem is Libya. With about 700,000 b/d of spare capacity, Libya is one of the major producers outside the Gulf holding a big chunk of the surplus available that could mitigate a Persian Gulf oil disruption. The others—Nigeria, Venezuela, Mexico, and Indonesia—are all likely to raise output and prices during an emergency to boost foreign earnings as much as they can. Libya is not as financially needy, and, because Tripoli is an ally of Iran, it may well refuse to help offset a shortfall precipitated by Tehran. [redacted] 25X1

Inventories—particularly government-owned stocks—can also play an important role in helping to offset a supply shortfall. At present, we consider only about 300 million barrels of commercial stocks in industralized countries as surplus to normal operating needs. An additional 500 million barrels are held in government-owned stockpiles. The lack of policies prescribing the use of these government-held stocks, however, would limit their effectiveness in calming the market during a disruption if companies believe they will not be available. [redacted]

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Chances are slim that a disruption in the Gulf, if it occurs, will be of such size and magnitude as to exhaust the market's surplus capacity and oil stockpiles. Nonetheless, given uncertainties about the likely supply response from excess capacity and stocks, the adjustment to a disruption in the Gulf is likely to be difficult. Based on past experiences, stockholders will be reluctant to deplete inventory supplies until the duration of the disruption is clear. Moreover, because companies profit from appreciation of the value of stocks while prices are rising, speculative pressures will reinforce precautionary motivations to hold on to stocks pending resolution of the crisis. Once normal supply is resumed, the large overhang of surplus capacity probably would drive prices back down. [redacted] 25X1

[redacted] 25X1

Briefs

Energy

OPEC Production

Contrary to industry forecasts that OPEC production would fall precipitously in January, OPEC output averaged 18.3 million b/d—the seventh consecutive month that production has exceeded the cartel's self-imposed ceiling of 17.5 million b/d. Saudi output dropped 400,000 b/d from month-earlier levels but remained above its implicit quota of 5 million b/d. Buyer hesitancy to enter Persian Gulf waters and a dropoff in Japanese liftings during contract negotiations caused Iranian output to fall 100,000 b/d, according to our latest estimate. 25X1 Output in Indonesia and Nigeria increased 100,000 b/d, respectively. [redacted] Nigeria has planned to further 25X1 boost output in February to more than 1.6 million b/d or 300,000 b/d above its quota. Despite a recent cold snap that firmed spot prices, the market remains weak because of OPEC's continued output above its ceiling. [redacted] 25X1

OPEC: Crude Oil Production *Million b/d*

	Quota	1982	1983 [a]	January [b] 1984
Total	**17.5**	**18.9**	**17.7**	**18.3**
Algeria	0.725	0.7	0.7	0.8
Ecuador	0.2	0.2	0.2	0.2
Gabon	0.15	0.2	0.2	0.2
Indonesia	1.3	1.3	1.3	1.5
Iran	2.4	2.4	2.4	2.2
Iraq	1.2	1.0	0.9	1.0
Kuwait	1.05	0.7	0.9	0.9
Libya	1.1	1.2	1.2	1.1
Neutral Zone	[c]	0.3	0.4	0.5
Nigeria	1.3	1.3	1.2	1.4
Qatar	0.3	0.3	0.3	0.4
Saudi Arabia	[d]	6.3	5.0	5.2
United Arab Emirates	1.1	1.2	1.2	1.2
Venezuela	1.675	1.9	1.8	1.7

[a] Estimated.
[b] Preliminary.
[c] Neutral Zone production is shared about equally between Saudi Arabia and Kuwait and is included in each country's production quota.
[d] Saudi Arabia has no formal quota; it will act as swing producer to meet market requirements.

[redacted] 25X1

Japanese Maneuver for Lower Priced Crude

[redacted]

Soft oil market conditions have prompted Japanese companies to turn away from long-term contracts and increase spot market purchases and deals with producers offering discounts. Besides giving the Japanese access to lower priced crude supplies, these tactics are designed to pressure Japan's other suppliers to be more competitive. Abu Dhabi's failure to meet Japanese demands for discounts and longer credit terms led the Japanese to refuse to renew some of their contracts that expired in January. Abu Dhabi was forced to cut its oil production in midmonth by 70,000 b/d. Abu Dhabi has offered a 90-day extension, rather than the standard 30 days, on credit terms but remains firm on prices. Previously, Japanese companies successfully pressed Iran to tie crude prices to spot prices in renegotiating contracts that expired in January. The Japanese are threatening to cut back on contracts with Iran due to expire in February and March, probably to gain additional concessions. Japan has increased its crude supplies from Oman, which is offering term contract buyers an extension of payments from 45 to 75 days, and has introduced a pricing formula to make its oil more competitive. [redacted]

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Japan Increases Government-Owned Oil Stocks

[redacted]

Japanese government-owned oil stocks rose by 9 million barrels last year and stood at 83 million barrels at yearend—about 20 days of net oil imports. The government plans to increase the stockpile to 189 million barrels by 1988. A reduction in commercial stocks more than offset higher government-owned stocks, leaving total oil stocks at yearend at 440 million barrels or down 24 million barrels from 1982. Total stocks, however, still represent 103 days of net oil imports in contrast to the period prior to the Iranian revolution when stocks represented only 82 days of net imports. Efforts to increase the government stockpile probably reflect Tokyo's concern over continued high dependence on Middle East oil supplies. Last year Japan imported 2.5 million b/d from the Middle East countries—60 percent of total import requirements. [redacted]

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Growing West European Interest in Libyan Petroleum Operations

[redacted]

West European firms are showing more interest in participating in Libya's petroleum production facilities. [redacted]

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US Embassy in Vienna reports that OEMV, the Austrian national energy company, is interested in purchasing a partial interest in US oil company holdings. OEMV apparently wishes to diversify its oil supply sources at minimal cost by investing in proven oil reserves. The willingness of European companies to assume a greater role in Libya's petroleum sector provides Tripoli with an alternative to its heretofore strong reliance on US firms for the expertise needed to exploit the country's hydrocarbon potential. [redacted]

[redacted]

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Finland To Increase Purchase of Soviet Gas

Under a new gas supply agreement signed in Helsinki on 10 February, Finland will boost imports of Soviet gas from 700 million cubic meters per year at present to over 2.5 billion cubic meters per year by the end of the century. Finnish gas demand will be increased by hooking up new customers—mainly industries and district heating plants—through an extension of the current pipeline network to Helsinki and Tampere. Although neither Finnish nor Soviet officials would disclose the agreed price of additional gas supplies, they indicated that—in contrast to previous agreements—the price would not be linked solely to oil prices. The agreement will increase Finland's already sizable dependence on Soviet energy supplies, and the apparent price flexibility evidenced by Moscow bodes well for other Soviet gas sales efforts to Turkey, Greece, and Sweden. [redacted] 25X1 25X1

Sabotage at Philippine Nuclear Power Plant

Since late last year, several cases of sabotage have been reported at the US-built and financed Philippine Nuclear Power Plant (PNPP) on the Bataan Peninsula. Electronic cables were severed from critical plant systems on at least two occasions, and in another incident, pumps were destroyed. These particular damages are not expected to cause significant delays. We believe dissident construction workers on site probably were responsible for the sabotage. We believe that additional acts of sabotage can be expected because the PNPP has become the focal point for vigorous opposition from antinuclear groups as well as anti-Marcos elements. The large number of temporary employees and the numerous construction deliveries make it almost impossible to protect a nuclear construction site against sabotage. Although the New Peoples' Army, an insurgent group, is active in the area, there is no evidence that they have targeted the PNPP. [redacted] 25X1 25X1

International Finance

Yugoslavia's Hardline Tactics With the IMF

[redacted] acceptance of the Fund's condition that interest rates match inflation this year could bankrupt many Yugoslav enterprises and cause severe political problems. [redacted] 25X1 25X1 25X1
[redacted] the Western banks and governments ready to offer debt relief for Belgrade this year still expect Yugoslavia to reach an IMF agreement. [redacted] 25X1 25X1 25X1

Bank and government debt relief agreements are conditioned on the Yugoslavs' reaching a 1984 standby agreement. The Yugoslav Government's tough position probably is designed to extract concessions from the IMF. Rejection of the IMF program would entail even more serious economic dislocations and political costs. [redacted] 25X1

Mexico Rescues a Brewery

Mexican treasury officials are preparing a financial bailout of a major brewery and have asked foreign creditors not to force the company into bankruptcy, [redacted] Like several Mexican firms, the brewery borrowed heavily abroad in the early 1980s and then saw its debt service obligations double because of peso devaluations. The brewery's problems have been compounded by a 40-percent decline in its domestic beer sales. The company's inability to reach a rescheduling agreement on $300 million in foreign debt brought its financial crisis to a head when one foreign creditor filed bankruptcy proceedings. Mexico City has already allowed the firm to defer payment of value-added taxes and is devising a rescue package that would include increased equity participation by the brewery's principal shareholders, restructuring of foreign debt, and additional tax relief. According to the financial press, a Mexican official said an offer by a large US brewery to purchase a controlling interest was rejected because additional foreign investment was not desired in this sector. [redacted]

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Mexican officials do not want the firm to go bankrupt because it would mean the loss of 5,000 to 8,000 jobs. In our judgment, they also fear that the firm's default would hurt efforts to complete the 1984 jumbo loan now being syndicated and would discourage banks, particularly US regionals, from reopening short-term credit lines. Mexico City has indicated its bailout will stop short of acquiring the firm, a move it could not afford given its austerity program. [redacted]

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Peru's Successful Financial Negotiations

Peru has successfully negotiated agreements with its private creditors and the IMF, providing a political boost for the Belaunde government. Last week in New York Peruvian negotiators and the bank advisory committee agreed to stretch out $2 billion in short- and medium-term debt repayments over a nine-year period at sharply reduced interest rates. The agreement cut interest charges by one-half percentage point to 1.75 percent over LIBOR, allowed a five-year grace period for principal repayments, and reduced front-end loan fees by one-half point. The financial package received favorable press treatment at home where both President Belaunde and Finance Minister Rodriguez-Pastor have been under fire for their handling of the economy. Rodriguez-Pastor indicated publicly that Peru has requested no new funds in 1984 beyond disbursements of the $200 million in loans delayed due to Lima's failure to meet IMF targets. Bankers have now agreed to disburse these funds based on the newly revised IMF agreement. [redacted]

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Peru and the IMF have signed a new letter of intent for an 18-month standby agreement worth some $265 million; it will replace the $700 million Extended Fund Facility initiated in mid-1982. Embassy sources report that the new program calls for limiting payments for military imports to $200 million in 1984, down from an estimated $350 million last year. We expect that Lima will agree to hold the public-sector deficit to near 4 percent of GDP, limit the loss of foreign reserves, and reduce inflation from 130 to 70 percent this year. We and most other experts believe that compliance with the new program will be difficult given strong domestic pressures against further belt tightening. [redacted]

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Tanzanian Fuel and Foreign Exchange Shortages

Foreign exchange shortages are threatening oil imports needed to ease gasoline shortages, according to the US Embassy. Although 59,000 metric tons of crude oil from Libya recently arrived in Tanzania, the delivery of 80,000 tons of crude oil from Iran and 24,000 tons of products from Bahrain scheduled for later this month are being held up by Tanzania's inability to secure $20 million in financing. Should the deals fall through, a recurrence of last June's severe 25X1
transportation problems is likely, and this will curtail the harvesting and export of key cash crops. 25X1

Global and Regional Developments

East Germany To Build Engines for Volkswagen

Volkswagenwerk AG last week announced plans to join East Germany in building a VW car engine plant, which would begin production in 1988. The announcement is another example of intra-German economic cooperation despite the political chill many expected would be caused by INF. Bonn, which owns 20 percent of VW and will be criticized for the loss of jobs at home, continues to push for better intra-German relations. East Berlin probably sees the venture as a politically low-cost arrangement with important economic benefits. 25X1

The agreement calls for moving an existing VW assembly line in Hanover, 25X1
West Germany, to an as yet undetermined site in East Germany. The East Germans are to deliver 100,000 engines each year in 1988-93 in return for finished vehicles. Agreement to build the 1,300-engine-per-day plant should help East Germany by:

- Providing enough engines for the bulk of its own auto production, even after deliveries to VW.
- Licensing a more advanced engine technology that will save fuel and help reduce air pollution.
- Saving hard currency by making the deal largely an exchange of goods and cutting East Germany's hard currency import requirements.

VW will benefit from East Germany's considerably lower labor costs and possibly expanded access to the East German market. 25X1

Cuts in Australian Iron Ore Prices

Australia's two largest iron ore producers have quietly acquiesced to a 12-percent cut in the price of iron ore shipped to Japanese steel mills. The Japanese pushed hard for the cuts, which lowered prices to 25 percent of 1982 levels. According to the US Embassy, the Australian firms feared that maintaining prices would have resulted in the Japanese switching purchases to Brazilian and Indian companies that already had reduced rates. Australia's 25X1
smaller iron ore producers are expected to follow suit, and total earnings this year from Australia's fourth-largest export will fall about $120 million. 25X1

Taiwan Seeking To Curb Trade Surplus With the United States

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Taiwan is seeking to reduce its growing trade surplus with the United States, which reached $6.7 billion last year. The government recently eased import restrictions on 86 items, although none are major imports from the United States. Government panels are considering several other steps—relaxing additional import restrictions, promoting US goods, establishing offshore export bases, and diversifying export markets. This goes beyond Taipei's previous efforts of calling on the United States to sell Alaskan oil and advanced arms to Taiwan and of sending buying missions. US purchases, predominately consumer goods and textiles, account for about half of Taiwan's total exports. 25X1

Taipei is aware of Washington's concerns about trade imbalances and wants to head off any US economic retaliation. Taiwan also is worried about the recent improvement in Sino-US relations and probably will attempt a further loosening of trade restrictions to improve its own standing in the United States. 25X1

National Developments

Developed Countries

Big Seven Inflation on the Rise

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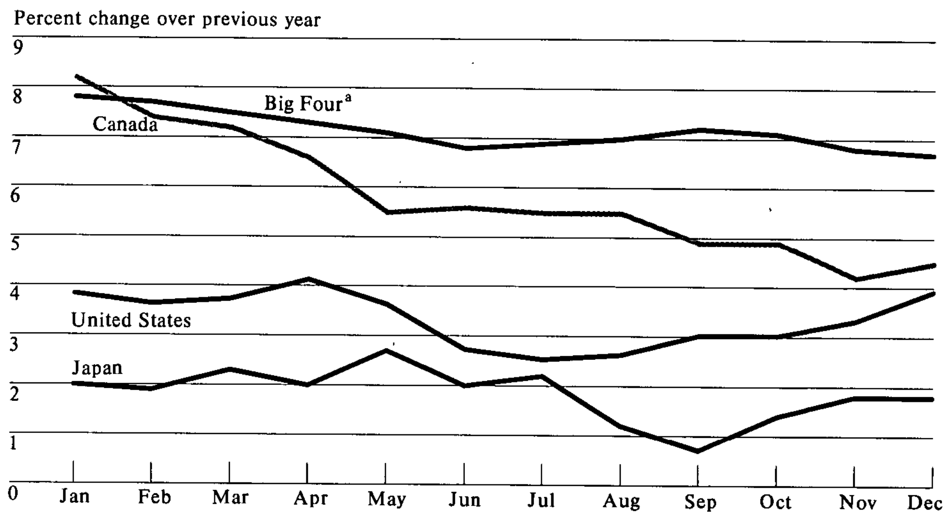
The acceleration in economic activity in the major industrial countries is starting to push up inflation. The 12-month rise in the combined Big Seven consumer price index edged up 0.6 percentage point to 4.4 percent in

Big Seven: Consumer Price Inflation, 1983



[a] Includes West Germany, United Kingdom, France and Italy.

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December 1983 from the August 1983 low. The pickup came from the economies that have been in economic recovery the longest—the **United States, Japan,** and the **United Kingdom**—leaving them with the same rates they had in December 1982. The United Kingdom posted the largest increase from the low reached in June—1.6 percentage points—ending the year with a 5.3-percent inflation rate. After dipping in September, Japanese price hikes quickened by December but still remained the lowest among the Big Seven. 25X1

With wage demands slowing under the pressure of record unemployment, **Canada** slashed its inflation rate in half in 1983. Still plagued with the largest price gains among the Big Seven, **Italy** nonetheless managed to cut inflation by the end of the year to 12.8 percent as the continuing Italian recession reduced domestic demand. **West German** inflation slowed by 1.4 percentage points since January 1983 to 2.5 percent as economic recovery only started to get under way. Despite the austerity program and price controls imposed by the Mitterrand government in 1982, French inflation seesawed during 1983, finishing the year at 9.3 percent. 25X1

Israeli Government Introduces Savings Incentives

At the initiative of Finance Minister Cohen-Orgad, a number of measures designed to encourage savings have been approved by a committee composed of cabinet members with economic-related portfolios. The measures include:

- Adding indexation for the last month that a deposit is held to avoid losses resulting from inflation.
- Establishing savings plans fully linked to the consumer price index that will pay real interest of up to 7 percent.
- Introducing one-month government bonds. 25X1

Cohen-Orgad pushed these proposals in an effort to reduce private consumption and to provide funds for investment, which has been anemic in recent years. We believe, however, that Israelis primarily will react by shifting the composition of their financial portfolios to take advantage of the new instruments. Businessmen, concerned about Cohen-Orgad's forecast of a 3-percent decline in real growth this year, remain reluctant to invest in modernization or expansion programs. 25X1

Black South African Unions Oppose Tax Changes

The 1 March enactment of a new income tax code could trigger black labor unrest. The code will eliminate racially separate income tax systems thereby enabling unskilled and semiskilled black workers to pay less. Tax payments by married black women and skilled workers, however, will rise by up to 40 percent. Although the code will reduce payments for about 90 percent of black taxpayers, a group of South Africa's largest black unions, representing over 250,000 workers, has called on the government to withdraw the new code. According to the US Embassy, the unions—many of which have a high proportion of skilled members—oppose Pretoria's unilateral action and taxation without representation. Many employers reportedly fear the tax change could cause widespread industrial strife because it has unified the rapidly growing and increasingly powerful black unions. The depressed economy and black vulnerability to layoffs, however, could brake the unions' response 25X1

Tokyo Provides Funds for Robot R&D

Japan's National Project to develop robots for use in hazardous environments is getting under way with the formation of a research association and substantial government funding. The eight-year, $95 million project was allocated only $170,000 in FY 1983 (April-March) largely because of budget austerity. In the FY 1984 budget, however, the project will get nearly $5.5 million, almost the entire amount requested, according to the Managing Director of the research association. In January, MITI announced the formation of the research association made up of 17 robot manufacturers and two industry associations. Of the seven research areas proposed, MITI chose three—a marine oil-exploration robot, a nuclear power plant robot, and a robot for disaster situations, such as fires or earthquakes. The technologies that must be developed for these applications—vision, sensors, mobility, control—will have broad applicability to industrial robots. Moreover, designing robots to operate in extreme conditions—high pressure, intense heat, and radiation—could have significant military applications.

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Less Developed Countries

Western Companies Attacked in Sudan

Chevron officials suspended all operations in Sudan last week because of recent dissident attacks on company personnel and facilities. This is a setback to one of the few bright spots in the Sudanese economy. Chevron was preparing the Unity oilfield for production of 60,000 b/d in 1986. A pipeline to transport the oil to the Red Sea was expected to be completed the same year, but its construction by an Italian consortium also will be put on hold. In addition, Chevron has stopped exploration work in a promising area of southern Sudan and we expect the French company Total, which is also looking for oil, to follow suit. Another French company, Compaigne de Construction Internationale (CCI), stopped work on the Jonglei Canal after nine of its workers were kidnaped in November. The canal had been scheduled for completion in 1986 and would bring additional Nile water to Sudan and Egypt. Last week dissidents blew up a CCI truck, killing 13 Sudanese workers, and a few days later attacked a CCI camp and captured six French nationals. We believe CCI will now abandon the canal project.

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Moroccan Grain Crop Jeopardized

Inadequate rainfall threatens Morocco's important winter grain harvest—90 percent of annual grain production. Southern production areas were devastated by drought in 1983, and prospects for this year's crop are rapidly waning. It is increasingly unlikely that total grain production in 1984 will exceed last year's 3.5 million metric tons, which was 20 percent below normal. Grain imports of 2 million tons could be necessary to meet demand in 1984 and this will jeopardize Rabat's foreign payments position and economic stabilization program. This would make it extremely difficult for the government to keep its austerity program on track without sharply increasing the risk of additional social disorders.

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Ecuadorean Economic Update

Ecuador's external accounts strengthened in 1983 under an IMF stabilization program, and this has paved the way for further gains this year. Despite progress, arrears on loan repayments continue to concern bankers. Devaluation and import controls allowed Ecuador to double its trade surplus to $750 million last year. Imports were cut about 30 percent to $1.3 billion, while exports held steady at $2.1 billion because of the soft oil and coffee prices and depressed demand in the Andean region. The trade surplus, coupled with a rescheduling of interest payments, enabled Quito to reduce its current account deficit by 60 percent to $566 million. Foreign payments progress, however, came at the cost of a 3-percent decline in economic activity. Consumer prices increased more than 50 percent because of devaluation, reduced price subsidies, and weather-induced declines in farm output. 25X1 25X1

Quito is looking for further improvements this year as a result of the IMF reforms, a return to normal weather, and increased oil production. The current account deficit is expected to shrink as exports rise and imports remain constrained. Rising agricultural output and austerity policies should cause a slowing of inflation. The goverment hopes the economy will grow slightly. 25X1

Ecuador's creditor banks recently agreed, in principle, to refinance debt maturing during the first half of 1984 and to suspend second-half payments until December. This will give a new administration taking office in August time to negotiate an accord with the IMF and international bankers later this year. In the interim, however, bankers remain skittish about lending $500 million in new money because of concerns about arrears and the ability of the lameduck Hurtado administration to maintain austerity. If bankers do not provide new money, Quito probably will run up arrears above last year's $500 million level. 25X1

Malaysia Cancels Fuel Subsidies

In another move aimed at reducing its large budget deficit, Kuala Lumpur recently removed government subsidies on diesel fuel and kerosene. Government officials expect the action to reduce the projected 1984 budget deficit of $3.25 billion by 5 percent. Not all of these savings may be achieved. Under pressure from fishing associations, Kuala Lumpur is devising a program to give direct diesel credits to fishermen. Moreover, tin miners, who are hard hit by the action, are expected to lobby the government to repeal the decision. 25X1

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Uncertainty Over Zairian Mining Reforms

A change in leadership at Gecamines, Zaire's national mining company, has created uncertainty over the future of IMF and World Bank requested reforms in the mining sector. Pierre de Marre was named last week as the new director of Gecamines, replacing fellow Belgian Robert Crem. According to US Embassy sources, Crem had antagonized the Belgian Government by trying to loosen Gecamines's ties to Belgian mining conglomerate, Societe Generale Minerais (SGM). In addition, Prime Minister Kengo reportedly criticized Crem for Gecamines's refusal to pay increased taxes and tariffs—losses that could undermine meeting IMF program targets. 25X1

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According to the US Embassy, it is likely that many of Crem's steps to reduce Gecamines's unprofitable dependence on commercial relations with SGM subsidiaries will be reversed to help patch up Zaire's economic relations with Belgium. De Marre's reputation from a previous stint at Gecamines suggests he will be more malleable and have closer ties to SGM. Renewed dependence on SGM probably will lead to the reintroduction of financial practices that some observers believe contributed to corruption. 25X1

Communist

China Buys Ground Station Canadian Satellite Equipment

The Canadian firm Spar Aerospace Ltd. will sell 26 satellite earth stations to the People's Republic of China under five contracts signed during Chinese Premier Zhao's visit to Canada last month. The equipment and related technology, valued slightly in excess of $20 million, is the largest sale of Canadian-designed telecommunciations equipment to China. In addition, Chinese engineers will receive technological training in Canada. 25X1

The latest sale apparently came as a surprise to the Canadians who believed the contracts would go to a US supplier. The Chinese decision to complete the sale with Spar Aerospace—at a cost of $2 million above comparable US offers—was probably based on political factors. In the aftermath of Zhao's visit to the United States, China may have wished to demonstrate that it could find alternative markets if the US was unwilling to provide for the transfer of sophisicated production technology and technical data to China. China may also take advantage of the sale to press US firms to lobby Washington for greater concessions to the Chinese. Ottawa has been eager to participate in the development of China's ground satellite system to boost Canada's international reputation in the telecommunications field and to increase exports of high-technology goods to China. 25X1 25X1

Hungary Limiting Consumer Spending

Hungarian authorities are acting more aggressively to curb consumer spending in an effort to deal with foreign payments problems. Hungary devalued the forint by 2 percent in early February to encourage exports to the West and reduce imports. stringent wage and price policies—including the 25 percent cut in consumer price subsidies—should lead to a 1- or 2-percent fall in real disposable income in 1984. This compares with an average annual increase of 1 percent a year during the past five years. To siphon off excessive liquidity, especially from the overheated private sector, the National Bank on 1 March will raise the interest rate on personal savings and time deposits by an average of 2 percentage points. 25X1 25X1 25X1

International Oil Market: Role of Surplus Capacity [redacted]

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The growing risk of a major escalation of the Iran-Iraq war increases the possibility of a disruption of oil flows from the Persian Gulf region. Free World surplus productive capacity, which at present approximates 8 million b/d, is concentrated in the volatile Persian Gulf. Moreover, some of the nearly 3 million b/d of excess capacity located outside the Persian Gulf may not be available should a disruption in the Gulf occur because one-fourth of it belongs to Libya. Inventories—both government and privately owned stocks—can also play an important role in minimizing a supply shortfall, but commercial stocks have been drawn down over the past year and policies to utilize government-owned stockpiles during an emergency remain uncertain. [redacted]

Sources of Supply

Based on our analysis, Free World available productive capacity this year will be slightly more than 52 million b/d.[1] This includes available capacity of 27 million b/d in OPEC countries. Non-OPEC producers have another 25 million b/d productive capacity, including 500,000 b/d in refinery gains and 1.5 million b/d in net Communist exports. Under current market conditions, available productive capacity in the Free World is more than adequate to accommodate this year's consumption needs, projected at about 45 million b/d by most industry forecasters. Under these conditions, we expect non-OPEC production to average about 25 million b/d this year, up slightly from 1983 levels. Although demand for OPEC crude in 1984 should rebound by about 1 million b/d from year-earlier levels, OPEC's share of non-Communist production will remain less than half for the second consecutive year. [redacted] 25X1

The Present Capacity Cushion in the Gulf

Given these oil supply and demand forecasts, and combined with our assessment of worldwide capacity levels, we believe surplus capacity in non-Communist countries will average about 8 million b/d this year. Seasonal variations in consumption and stock changes, however, can cause production and surplus capacity to vary as much as 2-3 million b/d during the course of the year. For example, we expect surplus capacity to swing from a high of about 9 million b/d in the second quarter to 7 million b/d in the fourth quarter. [redacted] 25X1

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Barring a disruption in Persian Gulf supplies, an oil shortfall originating outside the Gulf can be met. Most surplus capacity is concentrated in the Persian Gulf—about 5 million b/d. Moreover, many of the countries in the Gulf with surplus capacity—notably Saudi Arabia, Kuwait, and the United Arab Emirates (UAE)—are pursuing policies designed to keep oil prices stable at least through 1984 to avert a further decline in demand for their oil. In our view, these countries are likely to respond to a disruption elsewhere by raising output. Individually, Gulf countries—excluding Saudi Arabia—have surplus capacity as follows:

- Kuwait's surplus capacity currently is about 300,000 b/d. Continued market weakness has prompted Kuwait to slash its maximum sustainable capacity by 1 million b/d to 1.5 million b/d;

[1] Available capacity includes only those facilities on line and capable of responding almost immediately to a decision to raise production. Production ceilings imposed by individual producers for policy reasons are also taken into account. This discussion focuses on available capacity that most accurately measures the possible supply response to a disruption. [redacted]

25X1

Free World Surplus Productive Capacity,[a] 1983 and 1984

Million b/d

	1983 [b]					1984 [c]				
	I	II	III	IV	Year	I	II	III	IV	Year
Consumption	44.6	42.7	42.7	44.7	43.7	46.0	43.0	43.2	46.0	44.6
Inventory change	−3.7	−0.8	1.7	0.1	−0.7	−2.2	0.2	1.1	−0.6	−0.3
Production	40.9	41.9	44.4	44.8	43.0	43.8	43.2	44.3	45.4	44.3
Non-OPEC	24.2	24.3	24.7	24.8	24.5	25.0	24.7	24.8	25.2	24.9
OPEC	16.7	17.6	19.7	20.0	18.5	18.8	18.5	19.5	20.2	19.4
Free world capacity	53.5	53.0	52.5	51.9	52.7	52.3	52.2	52.5	52.8	52.5
Non-OPEC	24.8	24.8	25.0	25.1	24.9	25.4	25.2	25.3	25.6	25.4
OPEC	28.7	28.2	27.5	26.8	27.8	26.9	27.0	27.2	27.2	27.1
Surplus capacity	12.6	11.1	8.1	7.1	9.7	8.5	9.0	8.2	7.4	8.2
Non-OPEC	0.6	0.5	0.3	0.3	0.4	0.4	0.5	0.5	0.4	0.4
OPEC	12.0	10.6	7.8	6.8	9.3	8.1	8.5	7.7	7.0	7.8

[a] Including 1.5 million b/d net Communist exports.
[b] Estimated.
[c] Projected.

[redacted] 25X1

Kuwait's self-imposed production ceiling of 1.2 million b/d has been in effect for nearly three years.

- The UAE has imposed ceilings on individual fields that limit its surplus capacity to about 400,000 b/d. While the UAE is the most likely Persian Gulf producer to add capacity in the near term, sluggish demand and the OPEC production quota are retarding capacity development.

- Iraq presently has no spare export capacity available, and production has been limited to about 1 million b/d for over a year.

- We believe Iran could still raise output to 3.2 million b/d with little difficulty—about 1 million b/d above January 1984 production. Iran's export capacity has not been significantly affected by the war, but postrevolutionary policies deemphasizing oil production and Western participation have led to a sharp reduction in productive capacity. [redacted] 25X1

Saudi Arabia: A Special Case

Much of the erosion in Free World productive capacity that has occurred in the past year or so took place in Saudi Arabia. The combination of lower oil revenues and prospects for a continued weak market has led to large-scale cutbacks and "mothballing" of Saudi production equipment in an effort to reduce costs. This effort involves the shutting in of the southern Ghawar oilfield, Khursaniyah, and several other small fields. In addition, the Khurais field has been made part of the Saudi national reserve and taken out of production. As a result of these measures and the removal of selected facilities from the production system in other fields, available capacity was reduced to 8.1 million b/d by November 1983, [redacted] 25X1 This capacity level is intended to include facilities on line and capable of responding in 30 days to a Saudi decision to raise production. As a result, this removes a minimum of 2 million b/d of capacity

Non-Communist Oil Supplies, January 1984 [a]

Million b/d

	Available Capacity	Production	Surplus Capacity
Persian Gulf	**17.0**	**12.0**	**5.0**
Saudi Arabia	8.1	5.2	2.9
Iran	3.2	2.2	1.0
Iraq	1.0	1.0	0
Kuwait	1.2	0.9	0.3
United Arab Emirates	1.6	1.2	0.4
Qatar	0.6	0.4	0.2
Neutral Zone	0.6	0.5	0.1
NGL	0.7	0.6	0.1
Non-Persian Gulf	**33.3**	**30.5**	**2.8**
OPEC	9.7	7.3	2.4
Indonesia	1.6	1.5	0.1
Libya	1.8	1.1	0.7
Nigeria	2.2	1.4	0.8
Venezuela	2.4	1.7	0.7
Algeria	0.9	0.8	0.1
Ecuador	0.2	0.2	0
Gabon	0.2	0.2	0
NGL	0.4	0.4	0
Non-OPEC	23.6	23.2	0.4
Mexico	3.2	2.9	0.3
Norway	0.7	0.7	0
United Kingdom	2.5	2.5	0
Canada	1.8	1.7	0.1
United States	10.2	10.2	0
Other [b]	5.2	5.2	0
Total	**50.3**	**42.5**	**7.8**
Refinery gains and net Communist exports	2.0	2.0	0
Total Supply	**52.3**	**44.5**	**7.8**

[a] Estimated.
[b] Includes natural gas liquids (NGL).

from year-earlier levels that is immediately available to offset a disruption elsewhere.

The Saudis—with nearly 3-million-b/d excess available capacity right now—would still like to maintain the capability to restore capacity to 8.5 million b/d within 90 days and to 10 million b/d within a year. Reported problems in maintaining mothballed equipment, however, put into question the Saudi ability to raise production much above 8 million b/d. So far, the Saudis have been highly secretive about the capacity reduction, apparently in the belief that their market leverage depends as much on their perceived as actual capacity and that in an emergency they will have time to restore capacity. Riyadh remains interested in helping to insulate Saudi and Western economies from the effects of a disruption, having invested in a 1.9-million-b/d pipeline to the Red Sea in 1981 and having placed some 45-50 million barrels of crude into floating storage outside the Gulf late last year. 25X1

Surplus Capacity Outside the Persian Gulf

Over the next 12 months, only about 3-million-b/d excess capacity will be located outside the volatile Persian Gulf area, and nearly 90 percent of this total will be concentrated in OPEC member countries. Since non-OPEC producers have more flexibility to adjust prices to maximize sales, most are already producing at or near full capacity. The prospects that excess capacity in countries outside the Gulf would be made available during a disruption differ considerably, particularly among OPEC member countries. Nigeria, Indonesia, and Venezuela would be strongly motivated for financial reasons to raise output, but they also would be apt to take advantage of price pressures and charge as much as the market would bear. We believe that the response of Libya, an ally of Iran, would likely be motivated as much by political as economic reasons:

25X1

- Although Venezuela's financial situation over the past few years forced cutbacks in development of promising heavy oil reserves, we believe Caracas has the resources available to raise production quickly by about 700,000 b/d over recent output levels—to a level of 2.4 million b/d. 25X1 25X1

- In our view, Indonesia currently has about 100,000-b/d spare productive capacity. Extensive foreign participation in Indonesia's oil production and development probably would facilitate Jakarta's ability to raise output within 90 days.

- Based on industry assessments of Nigeria's oil production potential, we believe Nigeria probably could raise output to 2.2 million b/d on short notice from recent levels of about 1.4 million b/d.

- With current production of slightly more than 1.1 million b/d, Libya controls about 700,000 b/d of surplus capacity—one-fourth of Free World surplus capacity outside the Persian Gulf. Tripoli has enforced a self-imposed production ceiling of 1.8 million b/d in recent years, and we believe that available capacity has deteriorated to close to this level since the state oil company took over much of production responsibilities from US companies. [redacted]

We estimate that surplus available capacity in major non-OPEC producers outside the Gulf—Mexico, Canada, the North Sea, and the United States—currently is about 400,000 b/d, only about 5 percent of total Free World excess capacity. Mexico, which has about 300,000 b/d in shut-in excess capacity, is the only non-OPEC producer that we expect to maintain a sizable amount of spare capacity through 1984. As for other non-OPEC producers, we believe Canada has roughly 100,000-b/d spare capacity at present. North Sea producers have almost no surplus capacity as output continues to reach new peaks in the United Kingdom. The Department of Energy estimates that this year US productive capacity could fall by as much as 80,000 b/d. [redacted]

Inventories: An Addition to Available Supplies

Inventories—particularly government-owned stocks—can play an important role in minimizing the shock of a supply shortfall. At present, commercial stocks in industrialized countries represent 2.7 billion barrels, only 300 million of which are considered surplus to normal operating needs, in our view. An additional 500 million barrels are held in government-owned stockpiles. [redacted] 25X1

A large portion of these commercial stocks—about 55 days of consumption—represent minimum operating stocks needed to ensure a smooth functioning of the distribution system. Another 15 days represent compulsory stocks that companies maintain to meet government requirements. The balance of about nine days of consumption represents usable commercial stocks that provide added flexibility to meet seasonal as well as unexpected changes in demand. In addition, major oil-exporting countries hold about 200 million barrels in storage. Most of these are working stocks intended to provide some measure of flexibility to raise exports for a short period. [redacted] 25X1

Implications 25X1

While the current supply cushion is ample to keep the oil market soft under present circumstances, it is not adequate to overcome a major supply disruption in the Persian Gulf. A disruption in this critical area could well cause a supply loss that exceeds the level of supplies available to offset the shortfall. Moreover, not all of the 2.8 million b/d of available surplus capacity outside the Gulf would necessarily be brought into immediate production. The Libyan response to a disruption is particularly uncertain. [redacted] 25X1

In our view, uncertainties about the supply response from surplus capacity could have a harmful effect on the market reaction to a disruption, particularly if oil inventory holders perceived that sufficient 25X1 additional production might not be forthcoming. As it is, commercial stocks provide only a small cushion to cope with a major oil cutoff, especially in view of the tendency of companies to hold or even add to inventories until the end of a disruption is in sight. [redacted] 25X1

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We believe that the lack of specific plans for government-owned stocks during an emergency is a major drawback to the effectiveness of calming market fears at the onset of a disruption. A reluctance to use these government stocks except as a last resort would reinforce widespread company perceptions that such supplies are inaccessible and could lead to a scramble among purchasers for remaining oil supplies. [redacted] 25X1

[redacted] 25X1

South Korea: Strong Economy Boosting Chun's Prospects

25X1

South Korean President Chun's political standing has been given a big boost by the economy's strong performance in 1983. The numbers are impressive: export volume rose 15 percent, real GNP grew 9.2 percent, inflation was halved to 3.4 percent, and the current account deficit was held below $2 billion. We believe the odds favor continued high growth and low inflation in 1984 and beyond, which will help undercut criticism by Chun's opponents and broaden public support for his government. Nevertheless, the fiscal austerity needed to keep the government deficit in line will prevent Seoul from moving as quickly as promised on welfare programs.

Strong Expansion

Following a 5.6-percent increase in 1982, last year's real GNP growth of 9.2 percent put South Korea once again among the world's growth leaders. The high growth was particularly important for Chun because it was the first time his government achieved the type of growth Koreans had become accustomed to during the years under President Park.

The industrial sector led the economic advance with a production increase of about 15 percent in 1983. Gains were broad based with the biggest advances coming in heavy industry and technology-intensive industries. Electronics output, notably color TVs, video tape recorders, and semiconductors grew especially fast.

Domestic demand, which provided most of the stimulus to the economy in the first half of the year, benefited from stable prices. Private consumption rose 7 percent as real wages increased about 8 percent annually in 1982-83 because of the decline in inflation. Consumers stepped up spending especially rapidly on consumer durables such as autos, color TVs, refrigerators, and washing machines. 25X1

In the second half of the year, exports took over as the main driving force in the economy. For all of 1983, export volume rose about 15 percent with the gains concentrated in the US and Middle Eastern markets. Electronics and ships were South Korea's biggest sellers in 1983, while shipments of textiles and steel were flat. 25X1

Private investment increased about 14 percent in 1983. Lower interest rates sparked an extremely strong increase in construction. Investment in plant and equipment rose briskly because of rising capacity utilization rates, increased profits, and improved business confidence. 25X1 25X1

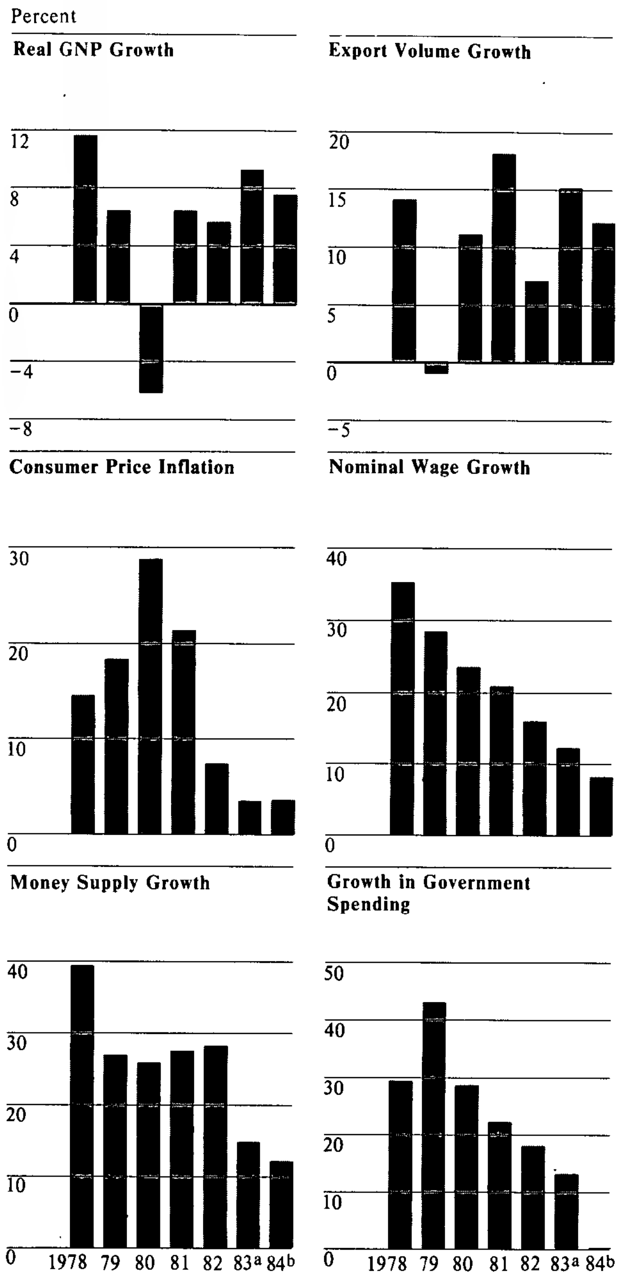
Low Inflation

Among the most positive developments in 1983 was the dramatic reduction in inflation. Consumer prices rose 3.4 percent last year—down from 29 percent in 1980—while wholesale prices rose less than 1 percent. Tight government fiscal and monetary policies, lower import prices, good grain crops, and slower growth in unit labor costs contributed to the decline. 25X1 25X1

Reduced Current Account Deficit

Seoul not only achieved high growth with low inflation—a goal few economists thought possible—but also reduced the current account deficit from $2.6 billion in 1982 to $1.6 billion last year. The decline in oil prices and the payoff from import substitution efforts held down the growth in imports while exports rose rapidly. In addition, lower international interest rates benefited the services 25X1

South Korea: Major Economic Indicators, 1978-84



[a] Preliminary.
[b] Projection.

[redacted] 25X1

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account. Seoul's economic performance impressed foreign bankers and South Korea had little trouble attracting foreign capital to meet its financing needs. [redacted] 25X1

Austere Policy Framework

President Chun and his economic advisers can take much of the credit for current economic conditions. In 1979 the Park government had begun to tighten fiscal and monetary policies, curtail labor cost increases, and slow private investment plans to deal with a seriously overheated economy. The Chun government strengthened these policies when it came to office in 1980 in order to wring high inflation and inflationary expectations out of the economy and to curtail the growth of the foreign debt. Korean economic planners believed stable prices were a prerequisite for maintaining high growth during the 1980s. Seoul was willing to accept several years of lackluster growth and declining living standards in exchange for low inflation and a manageable balance-of-payments position. Real GNP grew by only 1.7 percent per year during 1980-82 while import volume fell 1 percent annually. Real wages declined a total of about 5 percent during 1980-81. The government's policy mix has won praise from the IMF and foreign lenders who credit Seoul's policy package for the economy's strong performance. [redacted] 25X1

Restraint remains the watchword for 1984. The growth in the money supply, which was reduced from 28 percent in 1982 to 15 percent in 1983, is targeted at only 12 percent this year. An austere budget has been put in place, which cuts spending below the 1983 level and reduces the government deficit from 4 percent to 2 percent of GNP. In addition, Seoul has jawboned wage increases down from 25 percent annually in 1978-82 to about 12 percent in 1983 and is hoping to hold the increase to 6 percent this year. [redacted] 25X1

Bright Outlook

Barring external shocks, we project a strong year for the Korean economy in 1984. South Korea is well positioned to achieve its goal of 7.5-percent real GNP growth. Stronger global demand and a solid competitive position will enable South Korea to maintain rapid export growth in 1984. Exports have strengthened considerably in recent months; in November and December foreign sales were more than 30 percent above year-earlier levels. By gradually depreciating the won relative to the dollar and maintaining low inflation, Seoul has bolstered its competitiveness. We expect South Korea to achieve stronger export growth in Japanese and West European markets this year and to score big gains with its increasingly sophisticated electronics products.

Private consumption should increase about 5 percent in 1984 on the strength of rising real wages and employment. The growth in private investment will probably moderate somewhat from the extremely rapid 1983 pace because of tight credit conditions but will remain brisk in response to strong export demand.

Government restraint, moderate import price increases, and a good rice harvest should enable Seoul to hold inflation below 4 percent for the year. We expect slightly more rapid price increases in the second half of 1984 as the recovery enters its second year.

The current account deficit, in our judgment, will be somewhat smaller than last year's $1.6 billion. Export growth will be strong, but imports will pick up as producers rebuild inventories and raw material prices increase. The services' deficit may widen because of a reduction in overseas construction revenue. We believe Seoul has excellent prospects of attracting foreign funds to cover the red ink; South Korea's credit rating is good, and recent syndicated loans have been easily arranged.

Where Things Could Go Wrong

External factors loom as the most significant threat to the South Korean economy in 1984. Growing protectionist tendencies in the developed countries could hurt Korean exports. The greatest danger, however, would be a cutback in private bank lending. South Korea is potentially vulnerable because of its $40 billion foreign debt—the third largest among developing countries—about one-third of which is short term. 25X1

Bankers are monitoring South Korea closely, and any one of several events could undermine Seoul's currently strong international credit rating. Political instability in South Korea or a series of terrorist acts by North Korea, for example, could quickly lead to a loss in banker confidence. Under such conditions, we believe Seoul would impose extremely tough austerity measures that would reduce growth and employment and push up inflation.[1] 25X1

25X1

Political Implications

Although rapid economic growth has given Chun a boost, the size of the federal deficit and concerns over rekindling inflation have prevented the government from cashing in fully on the country's prosperity. The policies needed to keep a healthy expansion going constrain Chun's ability to deliver on politically attractive programs: 25X1

- Tight fiscal measures have prevented Seoul from moving as rapidly as promised in implementing welfare-oriented programs. South Korea's Fifth Five-Year Plan (1982-86) was publicized for the high priority it placed on housing, education, medical care, and other social programs. These plans have now been scaled back. 25X1

- Reduced government grain subsidies have angered farmers. To slash the budget deficit, Seoul has picked farm subsidies for major reform. Farmers will receive no increase in prices paid by the government for their rice this year. 25X1

25X1

- Tight credit conditions in the second half of the year have also generated criticism from the business community. Businessmen in Pusan and Taegu have been especially gloomy because of the shortage of funds. 25X1

In addition to the austerity program, two major financial scandals—one of which was rumored to involve relatives of the President—have tarnished Chun's image. The scandals underscored the weaknesses of South Korea's banking system and Seoul's unwillingness to reform it. 25X1

Nonetheless, we believe that the strong performance of the South Korean economy has significantly strengthened Chun's ability to build popular support and political stability. Most Koreans continue to rank improvements in their living standards as an important priority—more important than greater political participation—and exceeded only by national security. Continued high growth, low inflation, and increases in real incomes in the coming year will further consolidate Chun's position and help contain dissident activity. 25X1

25X1

Nicaragua: The Search for Oil Suppliers 25X1

Nicaragua's short-term economic prospects hinge on enlisting foreign patrons to foot a substantial share of its $135 million annual oil bill. Mexico—which until 1 February had supplied virtually all of Nicaragua's oil on long-term credit—is curtailing its concessionary financing. Most likely new suppliers are the USSR and such sympathetic Middle East countries as Algeria and Libya. Whatever the final arrangements, the Sandinistas will have to start paying for part of their oil, perhaps as much as $40 million over the next 12 months—a difficult task given already severe hard currency shortages. 25X1

The complexities of timing oil deliveries from several distant sources will make the economy more vulnerable to periodic oil disruptions. In addition, economic slowdown and increased shortages that will accompany rising oil costs are likely to generate further popular unhappiness with the regime. 25X1

Nicaragua: Current Account Balance, 1982-83 *Million US $*

	1982	1983
Current account balance	**−453**	**−645**
Trade balance	−369	−450
Exports (f.o.b.)	406	400
Of which:		
Coffee	124	157
Cotton	70	108
Imports (c.i.f.)	775	850
Of which:		
Oil	160	135
Net services and transfers	−84	−195

25X1

Venezuela Bows Out . . .

In late 1982 Venezuela cut off its shipments of 7,500 barrels per day (b/d) of crude—half of Nicaragua's oil supplies—because of $18 million in Nicaraguan arrearages. Venezuela has remained adamant that the overdue bills be paid before shipping any more oil. Caracas had supplied the crude under a 1981 Mexican-Venezuelan accord, which was intended to ease the burden of high oil prices on Central American and some Caribbean nations. The accord—which must be renegotiated each July—calls for Mexico and Venezuela each to ship Nicaragua 7,500 b/d of crude. Like all other recipients, Nicaragua was required to pay US dollars for only 70 percent of the oil on delivery, with the remainder due over five years. Mexico, however, never demanded that Managua meet the cash payment requirements. 25X1

Mexico Steps In . . . And Out

Mexico moved quickly to fill the gap created by Venezuela, doubling Mexican shipments to 15,000 b/d. Moreover, then President Lopez Portillo provided all the crude on long-term credit, thereby saving Nicaragua some $115 million annually in hard currency outlays. 25X1

President de la Madrid reassessed the bilateral relationship on taking office in December 1982. Without backing down from Mexico's basic commitment to support the Sandinistas, de la Madrid wanted to reduce Mexico's role as sole oil supplier. In an effort to prod Managua into finding some oil

supplies elsewhere, he began to gradually reduce oil delivery commitments at last July's accord renegotiation. Mexico cut its scheduled deliveries from 15,000 to 12,100 b/d for August 1983 through January 1984. For the six months thereafter—February through July 1984—de la Madrid scaled back commitments to 9,500 b/d and stipulated that, like all other accord beneficiaries, the Sandinistas now would have to pay cash for 80 percent of each shipment. Finally, de la Madrid required that in 1985 Managua would have to start repaying its previously accumulated oil debts—about $300 million. [redacted]

The Soviet Connection

The Sandinistas have turned primarily to the USSR and secondarily to sympathetic Middle Eastern regimes for concessionary oil. In an unusual departure from its cash-only policy, the USSR has contracted to deliver about $30 million worth of oil, accepting payment in Nicaraguan cordobas. [redacted]

In the expectation of receiving substantial quantities of concessionary Soviet petroleum, the Sandinistas will cut their oil purchases from Mexico, [redacted]

These expected Soviet and Mexican deliveries, plus current inventories, should allow the Sandinistas to maintain their roughly 12,000-b/d current consumption. Assuming Mexico sticks to its demand for 80-percent hard currency payment, the Sandinistas will have to pay more than $25 million for their oil over the next six months—not an easy task for their depleted treasury, particularly as $13 million in interest payments must also be met. [redacted]

We have no indication that the Soviets intend to provide additional concessionary supplies after June. Nonetheless, a precedent has been set. Having demonstrated its willingess to provide major (in the Nicaraguan context) hard-currency-equivalent support, Moscow may not want to be perceived as backing away from the regime the next time the Sandinistas ask for oil. We believe, however, that Moscow eventually will insist on either using its cordobas to buy Nicaraguan export crops—thereby reducing hard currency earnings—or being paid at least partly in hard currency for their oil. [redacted] 25X1

25X1

Other Possible Benefactors

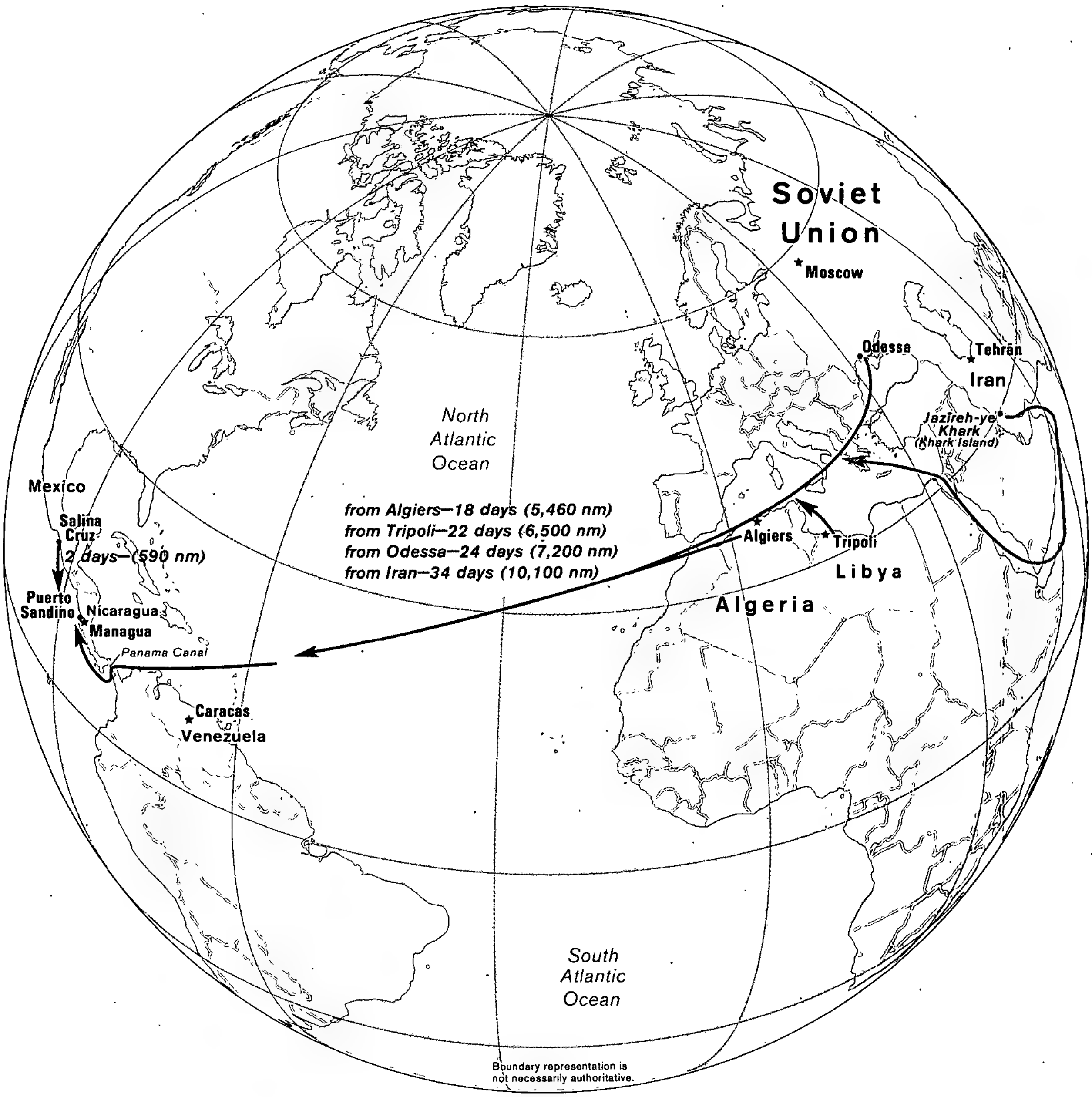
The Sandinistas are testing the waters with the sympathetic regimes in Algeria, Libya, and Iran by proposing to swap sugar—at twice the world price—for oil. **Algeria** reportedly has contracted to buy 80,000 metric tons of Nicaraguan sugar—about 80 percent of Nicaragua's 1982 export volume—at double the world price. [redacted] 25X1

The deal would finance perhaps $30 million worth 25X1 of crude oil to the Sandinistas—about two and a half months of consumption. This agreement would be consistent with the willingness of Algiers to dole out assistance to revolutionary socialist regimes of the Third World. Algeria would not, however, wish to do much more, to avoid being identified as a 25X1 principal, long-term benefactor of the Sandinistas. [redacted] 25X1

Libya has offered to supply an unspecified quantity 25X1 of oil if the Sandinistas arrange for the shipping, [redacted] 25X1 Tripoli would also accept sugar in return. We believe that Libyan leader Qadhafi 25X1 remains interested in strengthening the Sandinista regime to help undermine US interests in Latin America, and thus might agree to a deal similar to the Algerian arrangement. Given Qadhafi's frequent failure to keep aid promises, however, the Sandinistas probably will find him an unreliable supplier. [redacted] 25X1

25X1

Days Required to Ship Oil to Puerto Sandino, Nicaragua



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Junta coordinator Daniel Ortega recently announced to the press that **Iran** would begin providing "large quantities" of oil to the Sandinistas. We have no further information on such an arrangement, but Tehran could well see the provision of concessionary oil to Nicaragua as another way to counter US interests.

In the unlikely event that all the Sandinistas' efforts to find concessionary oil elsewhere fell through and Managua became desperately short of oil, Mexico probably would be willing to provide some additional supplies. Mexico City, however, would expect Managua to use whatever dollars it could to pay for the oil.

Managua's hopes that Venezuela will resume oil shipments are overly optimistic. Nicaraguan Finance Minister Cuadra reportedly has proposed that Caracas give Managua 20 years to pay off its oil debts and immediately begin shipping 7,500 b/d of crude under concessional terms. New Venezuelan President Lusinchi, however, has indicated to a US official that Caracas will continue to insist that the arrearages first be paid off in cash and would strictly apply the accord's requirements to any additional shipments.

Domestic Repercussions

Overall, we believe Managua may have to part with as much as $40 million in cash or hard currency export crops for its oil supplies over the next 12 months—up from practically nothing last year. Such an increase in oil costs will further reduce output and living standards. The higher bills for oil would roughly approximate the damage inflicted by anti-Sandinista insurgents in Nicaragua in 1983. The oil costs, however, would be more difficult for the Sandinistas to handle because they are all in foreign exchange.

In any event, assuring timely deliveries of adequate oil supplies from perhaps four or five different sources—particularly when Nicaragua is so peripheral to the interests of some of them—is likely to be difficult. The diversification implies much greater transport times, thus increasing the risk of periodic fuel shortages. The current priority given to military and industrial needs for fuel will magnify the impact on ordinary citizens, particularly if sudden shortfalls occur. Existing popular unhappiness with the regime over the widespread shortages and rationing of consumer items could worsen. Moreover, the petroleum link to the Soviets is hastening Nicaragua's reorientation of its economy away from the West and toward the CEMA countries.

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International Financial Situation: Current Account Outlook for Major Troubled Debtors

25X1

This article is part of a series focusing on economic and political aspects of the international financial situation.

25X1

We estimate that the 10 largest troubled debtors outside the Soviet Bloc [1] will record a combined current account deficit of about $10 billion this year—a $3 billion improvement over last year and about $30 billion better than the deficits registered in 1981 and 1982. We expect Mexico will again post the most favorable current account performance—about a $3 billion surplus—and Brazil the largest deficit at about $7 billion.

25X1

Factors Affecting Current Account Balances — *Percent change* (except where noted)

25X1

	1981	1982	1983	1984
OECD real growth	2.0	−0.3	2.5	3.7
OECD import volume	−2.0	−0.5	3.3	6.2
OECD dollar export price	−4.2	−3.5	−3.2	2.2
OPEC oil prices	11.0	−6.0	−10.0	−2.5
Agricultural prices	−12.0	−18.0	10.0	6.0
Minerals prices	−10.0	−14.0	7.0	4.0
LIBOR (percent)	16.8	12.2	9.5	9.3

25X1

Trade

The trade account continues to be the bright spot in the troubled debtors' economies. We project a $6 billion increase in their combined exports this year, sufficient to enable the first—although small—overall import rise in three years and a trade surplus of about $31 billion. Two key factors will spur exports:

- Real GNP in the OECD countries, which accounts for over 70 percent of these 10 countries' foreign sales, is projected to rise about 3.7 percent, the largest annual increase in six years.
- World agricultural and mineral prices, according to World Bank projections, will increase 6 percent and 4 percent, respectively. This is less than last year, but is in marked contrast to the 1981-82 declines.

Like most other economic forecasters, we expect oil prices to remain stable, barring an increase in Iran-Iraq hostilities, which could lead to a disruption of oil supplies. Oil accounted for about 40 percent of this group's exports last year. 25X1

Even with the $3 billion increase in combined imports we project for 1984, nominal imports of these countries will still be almost 40 percent below 1981 levels; because import prices also are down, we estimate real imports for the group will be about one-fourth lower than the 1981 level. Moreover, we believe Nigeria, Philippines, Morocco, and Peru will have to reduce imports even further in 1984. If IMF programs and financial packages for Argentina, Philippines, and Nigeria continue to be delayed beyond the first quarter, their imports could be lower than we presently forecast. 25X1

Services

In contrast to the improvement in the trade accounts, these countries' net services deficit will 25X1

[1] Brazil, Mexico, Argentina, Venezuela, Chile, Yugoslavia, Philippines, Morocco, Nigeria, and Peru.

Key Debt Troubled Countries: Exports and Imports, f.o.b.[a] *Billion US $*

	1981	1982	1983	1984
Total				
Exports	**112.2**	**99.2**	**97.6**	**104.0**
Imports	**118.2**	**97.8**	**70.3**	**73.3**
Argentina				
Exports	9.2	7.6	7.7	8.0
Imports	8.4	5.3	4.2	4.7
Brazil				
Exports	23.3	20.2	21.9	24.0
Imports	22.1	19.4	15.4	16.0
Chile				
Exports	4.0	3.8	3.7	4.2
Imports	6.6	3.6	2.7	3.3
Mexico				
Exports	20.9	22.2	22.1	23.0
Imports	24.0	14.5	8.5	11.0
Morocco				
Exports	2.3	2.0	1.9	2.1
Imports	3.8	3.8	3.4	3.3
Nigeria				
Exports	17.7	12.9	11.4	12.5
Imports	18.4	16.8	10.1	9.0
Peru				
Exports	3.2	3.3	2.9	3.2
Imports	3.8	3.8	2.8	2.7
Philippines				
Exports	5.7	5.0	4.8	5.3
Imports	8.4	7.8	7.2	6.1
Venezuela				
Exports	20.2	16.4	15.0	15.2
Imports	12.1	13.2	8.0	9.0
Yugoslavia [b]				
Exports	5.7	5.8	6.2	6.5
Imports	10.6	9.6	8.0	8.2

[a] For 1981-82 trade data are IMF figures, for 1983 they are estimates based on preliminary reporting, and for 1984 data represent CIA projections.
[b] Convertible currency area.

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remain near $40 billion, primarily because of interest payments. World interest rates in 1984 probably will average slightly less than they did in 1983, but the estimated $25 billion rise in total external debt of the 10 countries to an estimated $350 billion at yearend 1983 will add more than $2 billion in interest payments over the average level of the past two years. We expect improvement in other net services, such as tourism, travel, and profit repatriation, will nearly offset the additional interest payments. 25X1

Implications

While our current account estimates, which for many debtors are in line with official projections, point to larger export earnings and a cumulative trade surplus for these 10 troubled debtors this year, all of the surplus will be consumed by debt service payments. Moreover, real imports continue at very low levels. In our judgment, with foreign exchange surpluses transferred abroad to service debt, debtor governments are likely to question the benefits of the current debt strategy and its effectiveness in meeting LDC development needs. They may decide that, in the absence of lower interest rates, it is in their interest to consider postponing debt servicing in order to buy imports to fuel their economic recovery 25X1

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**Key Debt Troubled Countries:
Current Account Balances** [a]

Billion US $

	1981	1982	1983	1984
Total				
Current account balance	**−44.3**	**−43.2**	**−13.1**	**−10.3**
Of which:				
Trade balance	**−6.0**	**1.4**	**27.3**	**30.7**
Interest payments	**−33.2**	**−40.9**	**−39.5**	**−41.9**
Argentina				
Current account balance	−4.6	−2.5	−2.0	−2.2
Of which:				
Trade balance	0.8	2.3	3.5	3.3
Interest payments	−4.6	−5.3	−5.5	−5.5
Brazil				
Current account balance	−11.7	−16.3	−8.0	−6.7
Of which:				
Trade balance	1.2	0.8	6.5	8.0
Interest payments	−10.3	−12.6	−10.5	−11.4
Chile				
Current account balance	−4.8	−2.4	−1.4	−1.4
Of which:				
Trade balance	−2.6	0.2	1.0	0.9
Interest payments	−1.4	−2.0	−1.9	−2.0
Mexico				
Current account balance	−12.5	−3.0	4.4	2.8
Of which:				
Trade balance	−3.1	7.7	13.6	12.0
Interest payments	−8.4	−10.9	−10.6	−11.2
Morocco				
Current account balance	−1.9	−1.9	−1.8	−1.6
Of which:				
Trade balance	−1.5	−1.8	−1.5	−1.2
Interest payments	−0.8	−0.9	−1.0	−1.0
Nigeria				
Current account balance	−6.0	−7.3	−1.9	0.0
Of which:				
Trade balance	−0.7	−3.9	1.3	3.5
Interest payments	−0.5	−0.6	−0.9	−1.1
Peru				
Current account balance	−1.7	−1.6	−1.1	−0.9
Of which:				
Trade balance	−0.6	−0.5	0.1	0.5
Interest payments	−1.0	−1.1	−1.2	−1.4
Philipines				
Current account balance	−2.6	−3.4	−3.2	−1.5
Of which:				
Trade balance	−2.7	−2.8	−2.4	−0.8
Interest payments	−1.1	−1.8	−2.2	−2.2
Venezuela				
Current account balance	2.4	−3.4	1.8	0.8
Of which:				
Trade balance	8.1	3.2	7.0	6.2
Interest payments	−3.7	−4.0	−3.9	−4.1
Yugoslavia [b]				
Current account balance	−0.9	−1.4	0.1	0.4
Of which:				
Trade balance	−4.9	−3.8	−1.8	−1.7
Interest payments	−1.4	−1.7	−1.8	−2.0

[a] For 1981-82 trade and current account data are IMF figures, for 1983 they are estimates based on preliminary reporting, and for 1984 data represent CIA projections.
[b] Convertible currency area.

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International Financial Situation: LDC Trade Restrictions [redacted]

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This article is part of our series focusing on the economic and political aspects of the international financial situation. [redacted]

Foreign payments problems have caused a number of developing countries to tighten import restrictions over the last two years. Among major LDC debtors, only South Korea and, to a lesser extent, Peru have gone against the tide. [redacted]

Regulatory Climate

Import controls in developing countries tend to be complex, highly protective, and discretionary in nature. Mexico, for example, uses a combination of high tariffs, surcharges, import quotas, import licenses (for which high fees are sometimes charged), and prior approval requirements on imports by government entities. Import licensing is a particularly widespread technique because governments can use it to favor selected industries, regions, firms, or individuals. Such controls are often applied inconsistently and arbitrarily with disruptive effects on the private sector. The controls are usually portrayed as devices to help infant industries, but the primary motivation—particularly in recent years—usually is to improve the current account. [redacted]

Since LDC debtors urgently need to improve their export performance, imports used for the production of exports often are exempt from controls. Mexico requires licenses on virtually all imports, but among the items it exempts are spare parts and materials used to produce exports. The Embassy in Brasilia reports that, despite pervasive import controls, any firm with substantial exports has been able, sometimes with a struggle, to obtain needed import licenses. [redacted]

Recent Developments

During the last two years the financially troubled LDCs have used a variety of techniques to reduce imports. For many of the LDC debtors, foreign exchange controls have been of great importance. In Nigeria, for example, most potential importers simply do not have access to foreign exchange and thus do not have to contend with the elaborate import controls. [redacted]

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Licensing has been one of the methods most frequently used by LDCs to limit imports. Most countries have simply tightened existing controls rather than establishing new ones. Examples of import licensing in key LDC debtors include:

- *Argentina's* new licensing system classifies tariff items into several categories, including banned goods, goods that automatically receive permits, and items that must be cleared by a new import advisory committee.

- *Brazil* has tried to achieve targeted reductions in imports through selective issuance of import licenses. These are issued only if a shipment is in line with a firm's previously submitted annual import plan. Moreover, Brazil bans most goods for which there is a domestic substitute. 25X1

- *Chile* has required licenses on all imports over $500 since March 1983, and in some cases uses licensing to ration foreign exchange. In addition, Chile has increased tariffs across the board from 10 percent to 20 percent, and duties on some consumer goods have been raised to 35 percent.

- *Indonesia* allows only Indonesian nationals to import, and the Foreign Trade Ministry decides which firms may import certain items. 25X1

- Since 1982 *Mexico* has applied quantitative restrictions on the issuance of some import permits. It imposed licensing on imports into free trade zones in 1983.

- *Philippines* requires licensing on some imports and imposed a 3-percent surcharge on all imports last year. Prepayment of all duties and taxes is now required before letters of credit can be obtained. [redacted] 25X1

Outlook

A few debt-troubled LDCs have talked about easing their import restrictions but only as their financial problems subside. According to Embassy reporting, Brazilian officials hope to start phasing out controls in 1984, beginning with industrial materials and foodstuffs. The Mexican Government promised in its 1984 Economic Strategy Statement that it would ease existing emergency import restrictions. In our judgment, tough import control systems now in place in many other LDCs are unlikely to be relaxed any time soon [redacted] 25X1

[redacted] 25X1

Congo: Living With the Oil Slump

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The sharp falloff in oil earnings has prompted Congo to rein in an ambitious development plan, and as a result urban unemployment and business failures have increased. Congo, once one of black Africa's most ardent Marxist states, has drifted to the right after recognizing that earnings from its Western-operated oil industry were crucial to the nation's economic health. At the same time, President Sassou has recognized the need to preserve relations with Moscow to ensure continued access to military hardware. Sassou is likely to continue to seek financial assistance from Washington and other major Western governments, hoping that such aid will lessen the chances of a popularly supported move by his more radical critics to remove him while still courting the Soviet Union for military assistance.

Oil Boom and Bust

The dramatic change in the world oil market in the early 1970s offered Congo an opportunity to invigorate an economy saddled with a large government payroll and dependent on the small timber, sugar, and potash industries owned by the French. The leap in international oil prices in 1973-74 coincided with large new discoveries—particularly the 3.5-billion-barrel Emeraude field—and petroleum suddenly became Brazzaville's chief moneyearner.

Following the example of other Third World oil producers, Congo climbed aboard the economic development bandwagon by borrowing against future oil sales to fund an ambitious modernization program. The bubble burst when real oil prices slumped in 1975 and Congo was saddled with record current account deficits and a growing list of unpaid bills. When the USSR showed no inclination to provide either financial or technical assistance, Brazzaville looked toward the West for help.

When President Sassou took power in 1979, he adopted policies not markedly different from his predecessors'. Western reluctance to adopt Moscow's "no strings attached" policy of military aid reinforced his determination to preserve ties to the Soviets and access to their arms, a critical element in ensuring Army support. At the same time, Sassou continued to reach out to the West for financial and technical assistance to keep the country's oil-led economy healthy and to build for the time when oil reserves run dry—possibly in the early 1990s. 25X1

Oil Boom and Bust Revisited

Sassou's ability to pursue his policies was aided by another dramatic increase in oil revenues in the wake of the Iranian revolution and the Iran-Iraq war. US Embassy reporting indicates that between 1979 and 1982, oil production increased nearly 60 percent, and earnings tripled to $1 billion. This sudden influx of funds significantly strengthened Congo's foreign payments position and permitted the government to more than double expenditures each year from 1979 to 1982. 25X1

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Led by the petroleum sector, real GDP growth averaged nearly 8 percent annually during 1979-82. Foreign businessmen, bouyed by Congo's brighter economic prospects and pent-up consumer demand, invested heavily in the domestic market. Production in the forestry sector climbed substantially, construction activity picked up markedly, and even the beleaguered transport sector posted some gains. 25X1

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The boom was not without cost. Increasing numbers of Congolese migrated to the cities searching for their share of the oil wealth. The result was a

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Congo: Foreign Payments, 1979-83 *Million US $*

	1979	1980	1981	1982 [a]	1983 [a]
Current account balance	−142.2	−229.9	−504.7	−505.0	−755.0
Trade balance	132.7	365.4	269.1	285.0	55.0
Exports f.o.b.	495.7	910.5	1,072.7	1,135.0	950.0
Petroleum	338.5	664.0	906.0	1,000.0	800.0
Imports f.o.b.	363.0	545.1	803.6	850.0	895.0
Services and transfers	−274.9	−595.3	−773.8	−790.0	−810.0
Capital account balance	181.0	258.0	556.3	517.8	NA
Official capital	98.6	256.7	173.2	166.2	NA
Private capital	82.4	1.3	383.1	351.6	NA
Balance on current and capital accounts	**38.8**	**28.1**	**51.6**	**12.8**	**NA**
Errors and omissions	16.7	53.2			NA
Increase in central government deposits abroad	55.5	81.3	51.6	12.8	NA

[a] Estimated.

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sharp decline in agricultural production and record food imports. The rapid urban migration overwhelmed public services. Shortages of food and other necessities appeared, and urban joblessness grew. Inflation reached 18 percent in 1982, and housing costs doubled; corruption proliferated.

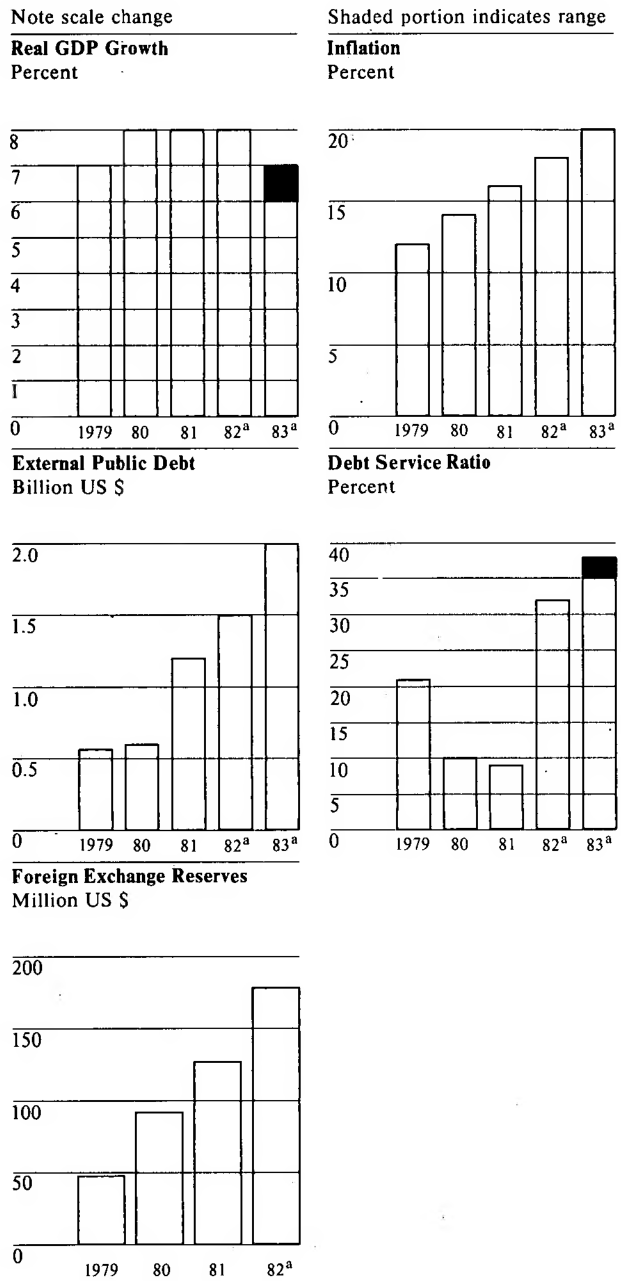
The Sassou government embarked on an ambitious $3 billion five-year investment program in 1982, heralding it as the blueprint for economic development against the day when oil runs out. The goal was to open up the inaccessible hinterlands to future development and to establish a variety of agricultural projects and light industries. The plan was based on the assumption that oil prices and production would both continue to rise.

Although there was some increase in Western aid, Sassou borrowed heavily to facilitate a rapid start-up of the development plan. The result was a doubling of the country's foreign debt in 1981 to $1.2 billion. Because most of the increase was in the form of short-term commercial loans, the debt service ratio soared to over 30 percent in 1982 compared with only 9 percent the year before. 25X1

The soft world oil market caused oil earnings last year to fall about 20 percent short of expectations. 25X1 Not only were prices below the level projected in the development plan, but export volume also was down. Imports of goods and services, however, did not decline, reflecting Brazzaville's determination to keep the development plan on track. Foreign borrowing continued to be heavy, and we estimate the external debt reached $2 billion by yearend. We estimate the country's debt service needs in 1983 absorbed slightly more than one-third of total foreign earnings. 25X1

The deteriorating financial situation coincided with worsening problems in the agricultural sector. Food production continued to fall because of the increasing migration out of rural areas, low producer 25X1

Congo: Selected Economic Indicators, 1979-83



[a] Estimated.

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prices, and inadequate rural roads for getting the product to market. For example:

- The production of cocoa and coffee for export plunged from an annual average of 10,000 metric tons during the 1970s to about 2,000 tons last year.
- The French-operated Nyaki sugar complex, which produced 100,000 tons at its peak in the late 1960s, produced only about 30,000 tons.
- Congo's timber industry—previously the primary export commodity—operated at half of capacity.

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At the Crossroads

There are some signs that the government is coming to grips with its financial problems. According to the Minister of Planning, the government has decided to pull back from some development goals. Priority transport and communication projects, such as the Congo-Ocean railroad, will proceed as originally planned, but proposals to improve productivity in industry and agriculture will be delayed. A new agreement with ELF that provides the company with a greater return is expected to spur exploration and oil production. 25X1

The need to rein in the country's development plan already has brought Sassou under fire from influential leftists within the party. They have long been critical of Sassou's ties with the West and cite the continued erosion in food production as a consequence of his policy of opening the economy to greater private and foreign participation. They also have pointed out the declining output in the sugar and timber industries and the inefficiencies in the government-owned enterprises. 25X1

We believe Sassou will have to juggle a myriad of competing interests to hold his political constituency together while dealing with the realities of reduced oil revenues. Economic problems have fanned longstanding tensions between the wealthier tribes in the south and those in the north who have held political power since 1968. Despite the alliance with some southerners and military leftists that

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allowed him to come to power, we believe that the continued political dominance by Sassou's northern Mbochi tribe rankles the better educated tribes in the more developed south. [redacted]

Sassou will have to ensure that cutbacks in development projects do not weigh too heavily on any particular group and that the surviving projects are allocated equitably. To mute continued criticism of his Westward-leaning economic policies, Sassou will have to placate the more leftist elements in his party with Marxist ideology, continued anti-Western rhetoric, and radical Third World stands in international forums. At the same time, however, we believe he will attempt to maintain good relations with the West to secure continued access to aid and investment funds. His job will not be any easier if oil prices do not improve in real terms until after 1985. [redacted] 25X1

Looking to the West

Sassou will seek Western support. In return for more generous terms, he expects ELF to move ahead on an ambitious $1 billion steam reinjection program that will improve the recovery rate of the Emeraude field. He probably will show continued interest in having US oil companies develop what Brazzaville believes are sizable untapped reserves. Finally, we believe that Sassou will step up efforts to acquire debt relief and increased concessional assistance from France, the United States, and other Western donors. [redacted] 25X1

Even if the West meets all of Sassou's expectations, he will still look to Moscow for military aid. Moreover, Sassou remembers Moscow's role in the assassination of one of his predecessors, and he 25X1
probably believes that the Soviet Union would not refrain from encouraging coup plotting by leftist and other disgruntled elements if he swings too close to the West. [redacted] 25X1

[redacted] 25X1

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